

# UKIP PARLIAMENTARY RESOURCE UNIT

## Rethinking Defence Procurement



# **Rethinking Defence Procurement**

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## Executive summary:

The UK is the world's fifth largest economy<sup>1</sup>, has the fifth highest defence budget<sup>2</sup>, and is the second highest spender in NATO<sup>3</sup>. Yet the Ministry of Defence has been plagued with procurement issues, which result in the UK defence industry delivering equipment which is late, overpriced, and does not match the specifications originally given. The failure of UK defence procurement undermines our national security.

In comparison to other countries, the UK gets very poor value for money in defence spending. The UK's defence budget is around 10% of the United States'. Yet in many critical areas (for instance airlift), the UK can field barely 1 or 2% of the US's capability. In some fields, such as space warfare and missile defence, Britain has no military capability at all. In most respects, the US Marine Corps alone provides the same military punch by land, sea and air as the Royal Navy, British Army and RAF combined – yet costs a great deal less to run.<sup>4</sup>

Inefficient procurement occurs in spite – or as a result – of the size of the organisation responsible for the procurement process. Defence Equipment and Support (DE&S), the semi-autonomous body of the Ministry of Defence responsible for purchasing and supporting the equipment that ministers choose to buy, directly employs 12,300 people. One person is employed by DE&S for every seven full-time soldiers in the British Army.<sup>5</sup>

This paper will argue that one of the key drivers of inefficient procurement is protectionism. The concerted policy of successive governments, explicitly stated in the Defence Industrial Strategy and National Security Through Technology, to privilege procurement from British, or more accurately partly-British, manufacturers not only increases cost and undermines efficiency but also diminishes – rather than promotes – both industrial and operational sovereignty. This approach to procurement therefore fails to achieve even its stated goal, and cannot be justified.

Favouritism of British defence contractors has also distorted the market. The effort to protect the defence industry has led to supply-side consolidation. This has created a seller's market, in which defence contractors set the terms of trade. As a result, competition has been limited, and failed projects have become the norm.

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<sup>1</sup> <http://databank.worldbank.org/data/download/GDP.pdf>

<sup>2</sup> <http://books.sipri.org/files/FS/SIPRIFS1504.pdf>

<sup>3</sup> <http://www.bbc.co.uk/news/world-31619553>

<sup>4</sup> *Encyclopedia of Military Science* by Guente Kurt Piehler, SAGE Publications, 2013.

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[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/417372/20150326\\_DE\\_S\\_Corporate\\_Plan\\_Final.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/417372/20150326_DE_S_Corporate_Plan_Final.pdf)

Procurement is hindered by other forms of protectionism too. Inter-service rivalry leads to lobbying for projects which are in the interests of different sectors of the defence establishment rather than the national interest.

In addition, the lack of enforceability of lobbying rules has enabled former officers to pursue inappropriate contracts on behalf of clients and connections in the years immediately following their retirements.

In the following, we will set out the negative consequences of protectionism for procurement and our national security. We will then propose reforms to improve value for money, decrease the power of vested interests, increase scrutiny, and combat improper lobbying. Our aim is to ensure that British defence procurement is geared first and foremost to keeping Britain safe.

## **1. What has gone wrong**

### **a. The Myth of Industrial Sovereignty**

UK defence procurement policy aims to privilege the British defence industry on the basis that doing so is essential to national security. The Defence Industrial Strategy, published in 2005, laid out this objective explicitly, stating: “The DIS will promote a sustainable industrial base, that retains in the UK those industrial capabilities needed to ensure national security.”<sup>6</sup>

However, the evidence of recent procurement projects demonstrates not only that the implementation of this policy has failed to procure functional equipment necessary for national security, but also that industrial sovereignty does not exist. British defence manufacturers are no longer able to produce equipment without international support. They draw extensively on a supply chain that typically spans a number of countries, and requires the consent of several governments. In fact, procurement from British contractors often entails the involvement of more foreign governments than procurement from foreign contractors. As a result, the unsuccessful effort to promote industrial sovereignty has also undermined operational sovereignty.

The myth of maintaining industrial sovereignty is exemplified by the effort to sustain the former Westland Helicopters factory located at Yeovil in Dorset. For decades, the Westland facility has been the only enterprise in the UK capable of extensively contributing to the construction of a military helicopter. Today, it is controlled by Finmeccanica, the Italian state aviation manufacturer, under the name AgustaWestland.

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<sup>6</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/272203/6697.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/272203/6697.pdf) p.6.

On 22 June 2006, the Ministry of Defence (MoD) placed a £1bn order for 70 Future Lynx helicopters (also known as the AgustaWestland AW159 Wildcat) to be built by AgustaWestland at its facilities in Italy and Yeovil. Forty of these were earmarked for the Army, and 30 were to be Navy weapon- and sensor-carrying combat versions. The new Lynxes thus cost an average of £14m each. Delivery commenced in 2011. In July 2009, it was announced that the cost of the programme had increased to £1.7 billion.

By comparison, five months later, the US Navy ordered a dozen Sikorsky Seahawks at US\$11.6m each: roughly £6m per helicopter at the time. Delivery was completed in 2007. The Seahawk is the naval, weapon-and-sensor equipped version of Sikorsky's Blackhawk utility helicopter. It is analogous to the planned Royal Navy version of the Future Lynx, though larger and more powerful. Basic Blackhawk aircraft, lacking the complex mission systems and electronics, would be even cheaper. A fleet of Seahawk/Blackhawks would have cost less than half the planned Future Lynx purchase, delivered better capability, and arrived at least three years earlier.

The Seahawk/Blackhawk would also have had an advantage in terms of technical support. Maintenance of the Seahawk/Blackhawk fleet would have required compliance from the US Government. Yet the Future Lynx requires support not only from the Government of Italy but from the US as well: the new Lynxes use American engines dependent on an American support base, and engine maintenance is one of the main limiting factors on helicopter operations.

Consequently, the Future Lynx actually offers *less* operational sovereignty than the Seahawk/Blackhawk, in addition to being more expensive, less capable, and slower to arrive. As such, purchasing the Future Lynx rather than the Seahawk/Blackhawk produced not only a worse outcome in terms of both value for money and national security, but also failed to promote meaningful industrial sovereignty and diminished operational sovereignty.

The Merlin HC3 utility helicopter, also produced by Agusta Westland, is a second example of the problems associated with pursuing sovereignty. The RAF originally purchased 22 HC3s, and has recently ordered 6 more. The operational responsibility has now been transferred to the Commando Helicopter Force. The Merlin HC3 can carry 24 troops or four tonnes of cargo, and each vehicle costs £32m.

In comparison, the Boeing Chinook HC2, also in service with the RAF, can carry 54 troops or 10 tons – over twice the capacity of the Merlin. Each vehicle costs around £20m, two-thirds the price of a Merlin. It is also significantly more serviceable. The lowest front-line serviceability ever seen for UK Chinooks was 60%, during a planned refitting period (2004-2005) after the invasions of 2001 and 2003; normal front-line serviceability for the

Chinook is 70% or above. The MOD typically expects to have 85% of its Chinooks in front line service.

By contrast, the Merlin has been much less available than the Chinook in recent years. The final target for the fleet, as of 2006, was to have 15 of the 22 aircraft in front-line service at any one time. During 2004-05, the MOD and AgustaWestland set themselves a target of 55% serviceability among the 15 front-line Merlin HC3s, meaning that an average of only 8 aircraft would be available for front line use at any time. According to the MoD's figures, that target has been achieved, barely. Yet, since 2005, only 5 helicopters were stationed in Iraq – the Merlin fleet's only operational commitment of the period. It seems unlikely that the MOD would deliberately keep back aircraft from the front line if they were useable.

British Merlins have displayed low readiness rates, and this has been consistent over a number of years. 2006 announcements of new technologies to be incorporated into the aircraft offered no indication of whether the planned modifications would address the structural issues that led to the loss of one Merlin, or the issues that led Canada to ground its Merlins for several months (due to persistent cracks in the tail rotor hub). The maintenance requirements for the Canadian version of the Merlin are 200% higher than the original forecast.<sup>7</sup>

As such, the Chinook not only carries twice what a Merlin can, it is also nearly twice as likely to be in a useable condition. Given that it is two-thirds of the price, the Chinook offers six times better value for money than the Merlin.

The Chinook also requires less overseas support, and therefore provides greater operational sovereignty than the Merlin. Whereas the Chinook requires only American support, the Merlin demands Italian and French cooperation as well as American support, since its cockpit avionics and missile countermeasures are both supplied from the US. Consequently, the Merlin dilutes British sovereignty far more significantly than the Chinook does.

The A400M project is a further example of this problem. The programme is intended to deliver a military turboprop transport, which can carry 30 tonnes of cargo a distance of 2,450 nautical miles, and which can operate from short and/or rough airstrips. Although the project began with a UK staff requirement in 1993, the formal order was only placed after protracted multinational negotiations in 2000. The MOD expected to pay approximately £100m each to acquire 25 planes ordered for the RAF, although delays – which will push the UK's aircraft final deliveries back to some undisclosed point near 2020 – have increased the cost to c. £150m per aircraft.

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<sup>7</sup> <http://www.defenseindustrydaily.com/2-bn-for-british-eh101-merlin-multirole-upgrades-01745/>

By comparison, the RAF also operates C-17 Globemaster transports. These were originally leased as a “short term” measure pending the arrival of the A400M, but they have proved so useful that they were purchased; negotiations are now underway to obtain more. Exact acquisition costs on the RAF C-17s are not publicly disclosed, but cannot realistically be more than £130m per aircraft given the declared whole-life costs – probably substantially less.

The Globemaster has slightly better range than the A400M (2,500 nautical miles as opposed to 2,450), and is 10% faster. It too can operate from short or rough strips. Its payload at this range is 75 tonnes as opposed to 30. As such, the Globemaster is conservatively 2.5 times better at moving cargo than an A400M, but each aircraft is still significantly cheaper.

Although production has recently finished, C-17s are also available right now, and the maker is keen to do business for delivery. By contrast, the delivery date of the less capable A400M has been continually pushed back. It was eventually scheduled for September 2015, 20 years after the C-17s were first used by the US.

Moreover, the A400M not only offers less capability and availability than the C-17 but also less operational sovereignty. Whereas the C-17 depends only on US support, full support for the A400M requires consent from the governments of France, Spain, Belgium, Germany, and Turkey in addition to the US, since the aircraft includes many parts and sub-assemblies built by American manufacturers. Again, the decision to purchase the “sovereign” product actually entailed greater loss of operational sovereignty than would have occurred had an off-the-shelf, foreign-made alternative been purchased instead.

The A400M programme has also failed even to safeguard the industrial base it was intended to protect. The MoD selected the A400M purely to preserve certain British aircraft-wing factories, part of the pan-European Airbus enterprise. Yet, with BAE Systems plc’s sale of its stake in Airbus, these plants are now under serious threat of closure anyway.

These examples illustrate that the privileging of British-based manufacturers does not maintain a sovereign industrial base capable of supplying British military requirements, or even necessarily maintain the specific factories and manufacturing capabilities it intends to support. Far from safeguarding sovereignty, this policy undermines operational sovereignty. It also results in higher costs, fewer defence capabilities, and consequently lower national security. Far from serving the interests of the country, this policy is part of a wider protectionist agenda that serves only the interests of certain defence contractors, as the next section will explain.

## **b. The Failure of Supply-Side Consolidation**

In a further effort to safeguard the UK defence industry, successive Governments have promoted manufacturer consolidation. The Defence Industrial Strategy of 2005 outlines this objective as well, stating: “There is potential for industrial rationalisation and consolidation and we will need to work with other European governments to identify whether a coordinated approach to sustain a viable industrial base is possible.”<sup>8</sup>

However, the result of consolidation is the emergence of an oligopoly. The amalgamation of suppliers has allowed the sellers to set the terms of trade. The UK defence industry has shrunk substantially, with fewer providers offering HM Government real choice when placing a new order. Whereas the US is capable of putting out a tender with four or five major defence contractors, the MOD is invariably limited to BAE Systems and occasionally European competitors for its largest projects. As a result, BAE Systems, rather than HM Government, has often been able to determine the terms of sale, including margins, cost overrun liabilities, and timescale for delivery.

The defence oligopoly has made it possible for contractors to make profits that exceed Government guidelines. UK defence companies benefit from unusually large profit margins. The Single Source Regulations Office was set up in December 2014, specifically to review “the standard rates used to determine the profit rate in pricing single source contracts.”<sup>9</sup> Current guidelines stipulate a margin of 10.6%. Yet according to SSRO chairman Jeremy Newman, anecdotal evidence indicates that, for the past five decades, the average margin on single-source contracts has been between 12% and 22%.<sup>10</sup>

The cost overruns to the QE carrier programme, and the UK taxpayer’s liability for them, exemplify the ability of BAE Systems to set the terms of trade. When the carrier order was announced in 2007, the projected build cost was £3.5bn; the current forecast is £6.2bn. For six years, 90% of cost overruns were covered by HM Government, with the supplier funding only the final 10%.<sup>11</sup> This is despite the fact that, with the exception of the change of plan regarding catapults, the specification has remained relatively constant, with successive governments making few significant alterations.

The overreliance on BAE Systems may also have serious consequences in terms of maintenance and safety. Charles Haddon-Cave QC’s review of the causes of the crash of a Nimrod aircraft in Afghanistan in 2006 concluded that BAE Systems, which was partly responsible for the aircraft’s safety, had systemic failings which directly impacted on the maintenance of the aircraft. “BAE Systems,” he wrote, “has failed to implement its expressed ethical business culture company-wide. The responsibility for this must lie

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<sup>8</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/272203/6697.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/272203/6697.pdf) p.9.

<sup>9</sup> <https://www.gov.uk/government/organisations/single-source-regulations-office/about>

<sup>10</sup> <http://www.ft.com/cms/s/0/63ee7aae-5471-11e5-b029-b9d50a74fd14.html#axzz3rBFOgugm>

<sup>11</sup> <http://www.ft.com/cms/s/0/40106756-4487-11e3-8926-00144feabdc0.html#axzz3rBFOgugm>



with the leadership of the Company.”<sup>12</sup> Singling out the three BAE employees, he suggested that its defensive stance had “lengthened the Review by many months.”<sup>13</sup> However, by dint of the lack of options, resulting from industry consolidation, the Government has continued to award contracts to BAE Systems in spite of the major, systemic failings indicated in the review. BAE’s market dominance not only prevents it suffering broader economic consequences from its failings. It also risks negatively impacting upon the safety of armed forces personnel.

In any market, when there is such constraint on supply, the seller sets the terms of trade. As the foregoing evidence testifies, defence is no exception. Successive governments have consolidated the supply base, thereby strengthening the hand of the producer at the cost of our armed forces, and the taxpayer. Again, a protectionist policy is undermining our national security.

### **c. The Impact of Inter-service Rivalry**

Defence contractors are not the only vested interest that affects procurement. Service chiefs also influence the procurement process by lobbying on behalf of specific factions within the armed forces. This is also a form of producer capture, which promotes the interests particular parts of the defence establishment at the expense of the national interest.

Inter-service rivalry permeates procurement. The ascendancy of one of the three services (the army, the Royal Navy, and the Royal Air Force) typically prompts concerns about negligence of the other two. During the unusually long term of the Chief of the Defence Staff, Air Chief Marshal Sir Jock Stirrup, army sources expressed fears that his tenure could lead to the Government’s neglecting the resources the army needed at the time, with counter-insurgency campaigns in both Iraq and Afghanistan.

This unease also extends to cancellations of projects and equipment. Although much consternation surrounded the apparently abrupt grounding of the UK’s harrier fleet in the 2010 SDSR, such planning was underway in 2008. The then Chief of the Air Staff, Sir Glenn Torpy, unveiled a proposal to scrap the entire Harrier fleet for the Royal Navy and RAF by the end of 2013. The First Sea Lord at the time, Sir Jonathan Band, was allegedly prepared to resign over the matter.<sup>14</sup>

Intra-service rivalry also impacts upon procurement. Looking to the 2015 Strategic Defence and Security Review, a paper published by Chatham House observed:

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<sup>12</sup> Page 303, “The Nimrod Review”, Charles Haddon-Cave QC, 28/10/09

<sup>13</sup> Ibid.

<sup>14</sup> “RAF and RN clash over plan to cut UK Harrier force”, Jane’s Defence Weekly, 12/12/08

“The British Army is more obviously divided along tribal lines as a result of the regimental system, and here the debate will focus on contending analyses of the future of conflict, each of which will suggest a different configuration of land forces. Thus, Royal Armoured Corps and Royal Artillery regiments are likely to emphasize the need to support NATO’s eastern allies in the face of a revanchist Russia—a task for which heavy armour will be indispensable. This argument would not only propose further spending on heavy equipment such as main battle tanks, infantry fighting vehicles and artillery, but would also mean a shift in the army’s balance of power away from the special forces, the Parachute Regiment and the county infantry regiments”.<sup>15</sup>

Factionalism within the armed forces does not promote the united thinking required to conduct procurement in the national interest. It too places the protection of producers above the national interest.

#### **d. The Influence of Lobbying**

There are also more insidious attempts to influence procurement, which the current law leaves unpunished. Former senior officers are able to ignore guidelines on lobbying in order to act on behalf of new clients in the defence industry. This is not only highly improper, but also intentionally subverts objectivity in the procurement process.

The Advisory Committee on Business Appointments (ACOPA) was created to ensure that former ministers, senior civil servants and special advisers do not take up jobs, upon leaving office, which may create “cause for any suspicion of impropriety”<sup>16</sup>. Yet ACOPA’s lack of sanction powers, arising from the fact that its recommendations are non-binding, render it powerless, and its guidelines unenforceable.

The practical consequence of this is that ACOPA’s guidelines are disregarded. In 2012, The Sunday Times published an investigation of four retired senior officers of the Ministry of Defence. Their filming revealed them to be “boasting about lobbying ministers and government officials to win multimillion-pound defence deals for arms firms”.<sup>17</sup> One, the former army procurement chief confirmed that he had helped to secure a £500m contract for an Israeli arms company client.<sup>18</sup> A former Royal Navy second in command, admitted that a way to get around the lobbying criteria was “basically to ignore it.”<sup>19</sup>

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<sup>15</sup> Cornish, P., and A. Dornish (2015) ‘Complex security and strategic latency: the UK Strategic Defence and Security Review 2015’, *International Affairs* 91: 2 (2015) 351–370

<sup>16</sup> <http://www.parliament.uk/documents/commons-committees/public-administration/PASC-Issues-and-Questions-paper-on-Business-Appointment-Rules.pdf>

<sup>17</sup> [http://www.thesundaytimes.co.uk/sto/news/uk\\_news/National/article1148358.ece](http://www.thesundaytimes.co.uk/sto/news/uk_news/National/article1148358.ece)

<sup>18</sup> <http://www.thesundaytimes.co.uk/sto/news/insight/article1147670.ece>

<sup>19</sup> <http://www.bbc.co.uk/news/uk-politics-19940473>

The failure to prevent such lobbying by former military personnel encourages corruption. This too benefits the defence industry at the expense of national security.

## **2. How to put procurement right**

### **a. Scrap the myth of industrial sovereignty: buy “off the shelf”**

“Buying British” is not a coherent policy. As discussed above, it delivers neither value for money nor efficiency nor sovereignty. Both national security and operational sovereignty would be better served by making the norm to buy defence equipment “off the shelf” from whichever manufacturer could deliver the best value product.

Changing the presumption of procurement to “off the shelf” purchases would entail the formal disavowal of the Defence Industrial Strategy (and its replacement, National Security Through Technology) and the issue of new guidance. This would recommend that the chief criterion for purchasing equipment would be its utility. The current method of blue-sky concepts and development from scratch should only be used where an item does not already exist, in which case a UK development project could seek to invent something new. Exceptions would be made for smaller, urgent requirements that the MOD needs. But, in general, equipment manufactured by foreign suppliers and offering better value for money than the “British” equivalent would no longer be subordinated to the purported interests of the British industrial base.

Normalising “off the shelf” procurement would also require the UK to abandon intellectual property demands when purchasing from overseas, under the banner of operational sovereignty. The practical result of these demands is to waste valuable diplomatic and political capital (usually in the US), and delay or threaten Britain's chances of buying cheap, effective equipment. In many cases, they also act as a mechanism to eliminate overseas competitors from contracts which British-based contractors believe they should win. Other nations do not find this kind of aggressive positioning to be necessary when buying from the US. Neither should the UK.

### **b. End the Oligopoly: consolidate demand, not supply**

Rather than privilege the seller, defence procurement needs to prioritise the interests of the buyer. HM Government, rather than defence contractors, needs to set the terms of trade.

This can be achieved through demand-side consolidation, by cooperating with allied countries in the tendering process. This should not entail working together from first specification through to delivery and a project's life cycle. Rather, the UK should

collaborate with NATO states, and others with closely aligned defence priorities, at the initial joint requirement stage to bargain more effectively with defence contractors.

This change can be readily and consistently implemented, and very nearly has been. The UK, France and Italy, some of the largest NATO spenders, agreed on the requirements for a new class of destroyers in 1992, issuing a Memorandum of Understanding<sup>20</sup>. Delays and disagreements led to the UK leaving that project, and Italy and France taking delivery of just four vessels between them. The eventual consequence was that the UK ordered six destroyers, rather than the original twelve, at exorbitant cost.<sup>21</sup> Pursuing demand-side consolidation in future would alleviate problems of this sort.

### **c. Reduce producer capture: Increase Parliamentary scrutiny**

The problematic influence of inter-service rivalry on procurement is facilitated by the centralisation of procurement decisions and the lack of significant outside scrutiny. In general, nobody is held accountable for failures in defence procurement. When a minister announces a contract award, there is little explanation as to why that option – typically involving more expense and delay for taxpayers than alternatives – had been chosen, or who has advocated it. To address this, the UK should increase the supervisory role and power of the Defence Select Committee.

The Defence Select Committee, rather than the Public Accounts Committee, should take the lead in scrutinising the work of Defence Equipment and Support and approving the Major Projects Report. The Select Committee presently only undertakes an annual review of the Ministry of Defence's annual report. Its role should be expanded to include scrutiny of the three year corporate plans produced by Defence Equipment and Support, as well as oversight of all major defence procurement projects. This would replace the ad-hoc and generally in arrears scrutiny currently undertaken by the Public Accounts Committee. As a result, the procurement process would be more transparent, and the Government more accountable.

Ultimately, if we really want to obtain value for money, the Defence Select Committee should also be required to authorise major procurement projects and approve the overall defence budget. Similar committee power is used in the United States Congress to significant effect. The Defence Select Committee should likewise be able to provide a check on the influence on spending decisions wielded by competing vested interests within the defence establishment.

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<sup>20</sup> "Partners say Horizon in service date could slip", Jane's Defence Weekly, 12/8/95

<sup>21</sup> <http://www.publications.parliament.uk/pa/cm200809/cmselect/cmpubacc/372/372.pdf>

#### **d. Stop improper lobbying: Make guidelines statutory**

Current recommendations on lobbying are ignored because they are unenforceable. This results in inappropriate procurement decisions which are against the national interest. To prevent this, accountability of former ministers, service chiefs, and personnel, as well as defence industry leaders must be improved. This would entail putting the rules against lobbying on the statute books, and introducing effective sanctions for miscreants.

To counter inappropriate lobbying, current ACOBA guidelines must be placed on a statutory footing, as recommended by the Public Administration Committee on 2012.<sup>22</sup> Those who broke the rules would then face legal censure. In addition, current guidelines should be extended beyond the most senior personnel. Statutory oversight should also apply to junior service personnel, civil servants, and those directly involved in the procurement process, who may also seek to exert improper influence on behalf of new clients after leaving the Ministry of Defence. The law must be effective against all those who may stand to gain from inappropriate lobbying if it is to be effective.

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<sup>22</sup> <http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-administration-select-committee/news/business-appointment-rules-report/>